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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In The Matter of	)	
	)	
IMPLEMENTATION OF THE PAY TELEPHONE RECLASSIFICATION AND COMPENSATION PROVISIONS OF THE TELECOMMUNICATIONS ACT OF 1996	)	**CC Docket No. 96-128**

COMMENTS OF THE TELECOMMUNICATIONS RESELLERS ASSOCIATION

The Telecommunications Resellers Association ("TRA"),[1] through undersigned counsel and pursuant to Section 1.429(f) of the Commission's Rules, 47 C.F.R. § 1.429(f), hereby offers the following comments in support of the petition ("Petition") of AT&T Corp. ("AT&T") seeking reconsideration of the *Second Report and Order*, FCC 97-371, released by the Commission in the captioned docket on October 9, 1997 (the "*Second Report and Order*"). TRA agrees with AT&T that the Commission's use of a "market-based" approach in setting per-call payphone compensation conflicts with both the decision of the U.S. Court of Appeals for the District of

[1] A national trade association, TRA represents more than 650 entities engaged in, or providing products and services in support of, telecommunications resale. TRA was created, and carries a continuing mandate, to foster and promote telecommunications resale, to support the telecommunications resale industry, and to protect and further the interests of entities engaged in the resale of telecommunications services. TRA has been an active participant in the Commission proceedings implementing Section 276 of the Communications Act of 1934 ("Communications Act"), as amended by Section 151 of the Telecommunications Act of 1996 ("Telecommunications Act"), 47 U.S.C. § 276; Pub. L. No.104-104, 110 Stat. 56, § 151(1996), as well as the United States Court of Appeals for the District of Columbia Circuit's review of the Commission's *First Report and Order*, 11 FCC Rcd. 20,541 (1996), and *Order on Reconsideration*, 11 FCC Rcd. 21233 (1996).

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Columbia Circuit ("D.C. Circuit") in *Illinois Public Telecommunications Association v. FCC*, 117 F.3d 555, *560, clarified on rehearing* 123 F.3d 693 (D.C. Cir. 1997), and the Congressional mandate embodied in Section 276 of the Communications Act, is illogical and constitutes bad public policy. Accordingly, TRA urges the Commission to grant the AT&T Petition and in so doing, to abandon its "market-based" payphone compensation scheme and predicate per-call payphone compensation on the forward-looking, economic cost of payphone origination of toll free and access code calls.

I. ARGUMENT

TRA agrees with AT&T that *Illinois Public Telecommunications Association v. FCC* effectively forecloses use of the "market-based" per-call payphone compensation scheme adopted by the Commission in the *Second Report and Order*. In *Illinois Public Telecommunications Association v. FCC*, the D.C. Circuit scolded the Commission for "fail[ing] to justify tying the default rate to local coin rates." 117 F.3d 555, 564. Indeed, the Court used terms such as "inexplicable" in rejecting the only grounds offered by the Commission to justify its "market-based" approach to per-call payphone compensation. *Id.* Moreover, the Court, in clarifying its decision, suggested that there was "little or no prospect" that the Commission's "market-based" approach could be "readopted upon the basis of a more adequate explanation." 123 F.3d 693.

In its *Second Report and Order*, the Commission nonetheless has once again utilized a "market-based" approach in setting per-call payphone compensation. While acknowledging the D.C. Circuit's objections, the Commission, undeterred, opines that "the court's decision . . . [did not] preclude[] . . . [it] from relying on market-based surrogates." FCC 97-371 at ¶ 23. In a remarkable leap of faith, the Commission then proceeds to simply affirm its "decision . . . to use a market-based default rate for per-call compensation for subscriber 800 and access code calls," offering as grounds for its action only the reasons set forth in its *First Report and Order* and *Order of Reconsideration*. *Id.* at ¶ 24. Thus, the Commission, without additional analysis, did precisely what the D.C. Circuit suggested could not be done even "upon the basis of a more adequate explanation." 123 F.3d 693.

While the Commission is correct that "[t]he 1996 Act does not prescribe a particular course to ensure that all PSPs are fairly compensated for each and every call," FCC 97-371 at ¶ 24, Section 276 does limit per-call payphone compensation to fair compensation. A requirement that payphone service providers ("PSP") be "fairly compensated" certainly cannot justify the extraction of monopoly rents. As the Commission has acknowledged, "there are certain locations where, because of the size of the location or the caller's lack of time to identify potential substitute payphones, no 'off-premises' payphone serves as an adequate substitute for an 'on-premises' payphone." 11 FCC Rcd. 20541 at ¶ 15. TRA submits that for transient callers, this is unfortunately more often the rule than the exception. Contrary to the Commission's stated belief, most payphones will thus not "face a sufficient level of competition from payphones at nearby locations to ensure that prices are at a competitive level." *Id.* And even where alternatives are reasonably proximate, TRA submits that it is simply not realistic to assume that a consumer, having located a payphone in an airport, or in a parking garage, or in a restaurant or on the street, will elect not to use that phone because there *might* be another payphone elsewhere that *might* be less expensive. Hence, it is unlikely that market forces will constrain payphone charges, leaving PSPs to extract monopoly rents for use of their facilities under the Commission's "market-based" compensation scheme.

Compounding this market imperfection, a caller using a payphone to reach a toll free number has no direct monetary interest in the transaction. Unlike the local coin market in which calls are always initiated by the person responsible for payment of associated charges, in the coinless market, a toll free caller has no incentive whatsoever to seek out a more affordable alternative. Accordingly, unless the toll free service subscriber or that entity's designated interexchange carrier ("IXC") has the ability to block calls on a payphone-specific basis and elects to exercise that option, there will be no market constraints on PSP pricing of payphone-originated toll free calls. And, of course, the Commission has hindered the ability of IXCs to selectively block payphone-originated calls by waiving the obligation of local exchange carriers ("LECs") and PSPs to deliver the payphone-specific coding digits necessary to do so.[2] As the Commission has acknowledged, the grant of this waiver "requires IXCs to pay compensation for certain calls without the ability to block those calls on a real-time basis." *Id.*

Apart from this glaring conflict with the statutory mandate, the Commission's "market-based" payphone compensation approach defies logic. As AT&T correctly points out, "a market-based approach to payphone compensation will encourage higher prices for <u>both</u> local coin and coinless toll calls, <u>even if</u> the market for local coin calls is vigorously competitive." AT&T Petition at 5. Because PSPs will have greater flexibility to gouge toll free service subscribers, who are not involved in (or even aware of) a caller's decision to use a given payphone, than local coin customers, who have a direct financial interest in the selection of a payphone, pricing for toll free calls will likely drive upward local coin prices.

It is for this reason (as well as the statutory mandate that compensation be fair) that rates for payphone-originated toll free and access code calls should be, as recommended by AT&T, determined "using a forward-looking, economic cost standard." AT&T Petition at 7. As the

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[2] <u>Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996</u> (Order), CC Docket No 96-128, FCC 97 2162 (Oct. 7, 1996).

Commission recognized in pricing network interconnection and unbundled local exchange network elements in implementing Sections 251 and 252 of the Communications Act, 47 U.S.C. §§ 251, 252, "economists generally agree that prices based on forward-looking long-run incremental costs (LRIC) give appropriate signals to producers and consumers and ensure efficient entry and utilization of the telecommunications infrastructure."[3] Indeed, the Commission has acknowledged that "a pricing methodology based on forward-looking, economic cost best replicates, to the extent possible, the conditions of a competitive market," encouraging "efficient levels of investment and entry." *Id.* at ¶¶ 672, 679. In so concluding, the Commission rejected as inefficient both market-based (or opportunity-cost) pricing and pricing designed to recoup embedded costs. *Id.* at ¶¶ 704 - 15.

The Commission has not disputed that per-call payphone compensation should be cost based; rather, it has mistakenly assumed that market forces are adequate to drive local coin and coinless payphone rates to cost, arguing that:

> a market-based rate best responds to the competitive marketplace for payphones consistent with the deregulatory scheme we adopted in the *Payphone Orders* for the provision of payphone services pursuant to Section 276, and also will effectively advance the statutory goals of encouraging competition and promoting the deployment of payphones.

FCC 97-371 at ¶ 24. As envisioned by the Commission, "[t]he marketplace will ensure, over time, that PSPs are not overcompensated." *Id.* at ¶ 97.

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[3] Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 11 FCC Rcd. 15499, ¶¶ 672 - 703 (1996), *recon.* 11 FCC Rcd. 13042 (1996), *further recon.* 11 FCC Rcd. 19738 (1996), *further recon.*, FCC 97-295 (Oct. 2, 1997), *aff'd in part, vacated in part sub.nom.* Iowa Utilities Board v. FCC, 120 F.3d 753 (1997) ("Iowa Utilities Board"), *modified* 1997 U.S. App. LEXIS 28652 (8th Cir. Oct. 14, 1997), *pet. for cert. pending sub. nom* AT&T Corp. v. Iowa Utilities Board (Nov. 17, 1997), *pet. for rev. pending sub. nom.*, Southwestern Bell Telephone Co. v. FCC, Case No. 97-3389 (Sept. 5, 1997).

It is the Commission's misperception of the payphone market as competitive that has led it to reject forward-looking, economic pricing. Thus, the Commission variously asserts that forward-looking, economic pricing is "inapplicable" in this instance because "the payphone industry is not a bottleneck facility that is subject to regulation at virtually all levels," that "the PSP will be providing a competitive service (payphone use) and should therefore receive compensation equal to the market-determined rate for providing this service," and that "reliance on cost studies, *in general*, could reduce the number of payphones deployed." *Id.* at ¶¶ 93 - 95. Moreover, the Commission adds that setting prices that "recover a reasonable share of joint and common costs would require the difficult allocation of those (large) costs among the different types of calls made from payphones." *Id.* at ¶ 96.

Certainly, the higher the level of per-call payphone compensation, the more payphones potentially that will be deployed to exploit the opportunity to charge inflated rates. Such investment and facilities deployment is hardly efficient, however. As noted above, the Commission has acknowledged that pricing reflective of forward-looking, economic costs encourages "efficient levels of investment and entry" because it "replicates . . . the conditions of a competitive market."[4] Replication of a competitive market is necessary because payphones are, simply put, mini-(locational)-monopolies for which viable alternatives are often not readily available at the moment of consumer choice. As noted above, it is simply not realistic to assume that callers will identify multiple payphones at multiple locations before selecting the most cost-effective alternative. Thus, while any given payphone may not be accurately described as a "bottleneck," it likely will be the only readily available option to a consumer on the move. In an airport, at a particular gas station or

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[4] Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 11 FCC Rcd. 15499, ¶¶ 672, 679.

in a given restaurant or bar. PSPs are not providing a competitive service; they are providing the only landline communications opportunity. And avoidance of annoying cost allocations is indeed a sad rationale for licensing mini-monopolists to gouge the public.

Finally, the Commission's "market-based" pricing scheme constitutes bad public policy. Consumers generally will not be well served if forced to pay (directly or indirectly) inflated charges for payphone-originated calls. TRA's focus, however, is on the adverse impacts excessive payphone compensation will have on the many small to mid-sized carriers that comprise the "rank and file" of its membership. TRA is an association comprised in large part of small to mid-sized resale carriers serving primarily small to mid-sized business customers.[5] The impact of regulatory requirements on TRA's resale carrier members tends to be magnified because of their smaller size and relatively limited financial resources. In this instance, the harm that will be visited upon these small to mid-sized carriers if payphone compensation amounts are not rationalized will be potentially devastating for many.

The small business customers of TRA's resale carrier members are highly resistant to the imposition of additional charges, particularly large, unanticipated assessments. The experience of TRA's resale carrier members to date in attempting to pass through payphone compensation, paid either directly or to underlying network service providers in conjunction with

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[5] While the telecommunications resale industry is a maturing market segment comprised of an eclectic mix of established, publicly-traded corporations, emerging, high-growth companies and newly-created enterprises, the "rank and file" of TRA's membership is still comprised of small to mid-sized carriers serving small to mid-sized businesses. The average TRA resale carrier member has been in business for five years, serves 10,000 customers, generates annual revenues of $10 million and employs in the neighborhood of 50 people. The average customer of a TRA resale carrier member is a commercial account generating $100 to $1,000 of usage a month. In other words, the average TRA resale carrier member is an entrepreneurial venture, which has gained a solid, but nonetheless competitively precarious, foothold in the telecommunications industry Source: TRA's "1996 Reseller Membership Survey & Statistics" (Sept. 1997).

the FCC's interim compensation mechanism, has confirmed the intensity of this resistance, as well as the adverse competitive ramifications of attempting to impose large new charges on small commercial accounts. Unfortunately, smaller resale carriers, unlike some of their larger network-based competitors, do not have the traffic volumes over which to spread amounts paid to originate toll free or access code calls from payphones without significantly increasing rates. Nor do smaller carriers have the operating margins within which to absorb such amounts without adversely impacting their financial viability.[6]

This inability to pass through to customers or to absorb amounts paid to PSPs to originate toll free and access code calls presents smaller resale carriers with a "Hobson's Choice" of sorts. Should they pay inflated compensation amounts to PSPs and suffer the adverse financial consequences, or should they block calls from all or particular payphones and suffer the resultant revenue loss? As the D.C. Circuit observed, "blocking is hardly an ideal option for the IXCs, for it is not only expensive to implement . . . but its use invariably will result in a mutual loss of business for both the PSPs and the IXCs." 117 F.3d 555 at 564.

Smaller carriers tend to serve niche markets and, accordingly, are often much more reliant upon a particular service offering than their far larger network-based competitors. For example, pre-paid and post-paid calling cards are a central service offering for many of TRA's resale carrier members, and, accordingly, these carriers rely heavily upon pre-paid and post-paid calling

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[6] Of course payphone compensation is only one of several large new regulatory assessments being levied on small to mid-sized carriers (and their small business customers) by the Commission. Such carriers are now paying the new $2.75 per month, per line multi-line business preferred interexchange carrier charge and will soon be contributing roughly four percent of their end user revenues to universal service support mechanisms. *See* 47 C.F.R. 69.153(d); Public Notice, DA 97-2392 (First Quarter 1998 Universal Service Contribution Factors Revised and Approved) (released Dec. 16, 1997).

card revenues for financial viability. For such carriers, blocking access code calls from all or some payphones is a painful alternative. Call blocking severs a key revenue stream, limiting business options and leaving customers disgruntled.

While blocking calls from individual payphones is not an attractive alternative for small to mid-sized, call blocking at least permits smaller providers to exercise financial control, and perhaps negotiate a more rational compensation level. Absent call blocking, smaller carriers face potential financial liability of unknown proportions, all too aware that their prospects for recovery of such amounts from their small business customers are limited.

Unfortunately, call blocking is not possible in the absence of payphone-specific coding digits and such data is simply not available from upwards to 40 percent of payphones.[7] Thus, smaller IXCs that desire to avoid paying inflated payphone compensation are left with an even less attractive alternative - *i.e.*, ceasing to provide key services.

Exacerbating this problem are the unique circumstances facing the many TRA resale carrier members which are currently offering pre-paid calling cards. A pre-paid calling card provider must have "real-time" access to payphone-specific coding digits in order to debit charges unique to payphone-originated calls. Absent such "real-time" access, pre-paid calling card providers have no way to recover amounts paid to compensate PSPs for the access code calls placed using pre-paid calling cards; the one and only time such recovery can be effected is when a call is placed. Monthly or quarterly statements are meaningless when cards can be depleted with a single call. Thus, without payphone-specific coding digits, pre-paid calling card providers will have no choice but to absorb

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[7] Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996 (Memorandum Opinion and Order), CC Docket No 96-128, FCC 97-2622, ¶ 11 (Dec. 17, 1997).

amounts paid to compensate PSPs for payphone-originated access code calls and to suffer the obvious adverse financial consequences.

In short, AT&T is correct that "[t]he *Second Report and Order* is riddled with factual and conceptual errors that should be rectified on reconsideration -- particularly because the effect of the errors is to impose excessively high costs on carriers and consumers." AT&T Petition at i.

II. CONCLUSION

By reason of the foregoing, the Telecommunications Resellers Association urges the Commission to grant the AT&T Petition and in so doing, to abandon its "market-based" payphone compensation scheme and predicate per-call payphone compensation on the forward-looking economic cost of payphone origination of toll free and access code calls.

Respectfully submitted,

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January 7, 1998

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CERTIFICATE OF SERVICE

I, Marie E. Kelley, hereby certify that copies of the foregoing document were mailed this 7th day of January, 1998, by United States First Class mail, postage prepaid, to the individuals on the attached service list.

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